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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 60

GROVER D. TURROW and RUTH H. TURROW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF PETITIONERS

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BRIEF OF PETITIONERS

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 29-42) are reported at 32 T.C. 646. The opinion of the Court of Appeals (R. 54-64) is reported at 286 F.2d 669.

JURISDICTION

The judgment of the Court of Appeals (R. 65) was entered on December 5, 1960. The petition for a writ of cer-

tiorari was filed March 2, 1961, and was granted May 15, 1961 (R. 66). The jurisdiction of this Court is invoked under section 1254 of Title 28 of the United States Code.

STATUTES INVOLVED

The case directly concerns the application of § 112(c)(1) of the Internal Revenue Code of 1939 (53 Stat. 39), which provides in pertinent part:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph * * to be received without the recognition of gain, but also of * * money, then the gain * * to the recipient shall be recognized, but in an amount not in excess of * * such money * *."[1]

The full text of this statute and the pertinent portions of other statutes referred to herein and in the argument below—namely, §§ 112(a), (b)(3), (d), (e) and (g) of the Internal Revenue Code of 1939 (53 Stat. 37-40) and §§ 356 (a) and (c), 368(a), and 381(a) and (c) of the Internal Revenue Code of 1954 (68A Stat. 115-129 as amended)—are set out in the appendix to this brief. For convenient reference, the appendix also contains excerpts from Treasury regulations which have been discussed in the course of proceedings below.

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[1]These provisions are retained in substantially the same form in the Internal Revenue Code of 1954, § 356(a)(1), 68A Stat. 115, Appx. infra, p. iv.

QUESTION PRESENTED

Whether, under § 112(c)(1) of the Internal Revenue Code of 1939, the gain to a taxpayer who has exchanged all of the voting stock of one corporation for a part of the voting stock of another corporation plus cash is recognized in the year of the transaction only to the extent of the cash, postponing recognition of the gain (if any) on the stock received until it becomes the subject of some later taxable transaction.

STATEMENT OF THE CASE

The facts are not in dispute. As the Tax Court found (R. 36):

The taxpayer[2] owned all 5000 shares of the outstanding stock, all of which was voting stock, of International Dairy Supply Company, a Nevada corporation (hereinafter called "Supply")[3] (R. 30, 31). Supply's business, in the main, was furnishing reconstituted milk and milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States (R. 30-31).

Foremost Dairies, Inc. (hereinafter called "Foremost"), was a New York corporation engaged in the busi-

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[2]References to the taxpayer in this brief are to Grover D. Turnbow, inasmuch as his wife, Ruth H. Turnbow, is a party only because she filed a joint return with her husband for the taxable year involved.

[3]The taxpayer owned interests in two other corporations, which also entered into the transactions herein described. However, since there is now no issue in any way involving these other interests, reference to them is hereinafter omitted.

ness of processing and distributing milk, cream, and other dairy products (R. 30).

In 1951, Foremost and the taxpayer entered into an agreement under which Foremost was to acquire all of the stock of Supply (R. 32). Upon completion of preliminary negotiations, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and the taxpayer on February 11, 1952. The Amendatory Agreement included, inter alia, the reorganization plan (R. 32).

Under the reorganization plan Foremost was to acquire from the taxpayer all of the capital stock of Supply, and the taxpayer was to receive in exchange 82,375 shares of the common stock of Foremost (a minority interest), plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. It was not to make any distribution to its shareholders in pursuance of the plan of reorganization or otherwise (R. 32-33).

The reorganization plan also provided for many changes in the management of both Foremost and Supply, with Turnbow to be president and general manager of Supply and also a director and chairman of the executive committee of Foremost and general manager of its Western and International Division, and with the right to name three of Supply's six directors and two of Foremost's directors (R. 33-34).

The terms of the Amendatory Agreement were carried out (R. 34).

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and the taxpayer

received 82,375 shares (then having a fair market value of $15 per share) of the common stock of Foremost and $3,000,000 cash, in exchange for all of the capital stock of Supply. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77 (R. 34-35).

In his 1952 income tax return the taxpayer reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77 (R. 35).

The Commissioner determined that the recognized gain from the transaction should be increased by $1,178,699.17 (the value of the Foremost stock at the date of the exchange less the cost basis of the stock of Supply, with certain adjustments not material here) (R. 35-36).

On the taxpayer's petition for redetermination, under § 272 of the Internal Revenue Code of 1939 (53 Stat. 82), the Tax Court held that the recognized gain on the transaction was limited to the cash "boot" (R. 29-42).

On petition for review under § 7482 of the Internal Revenue Code of 1954, the court below reversed the Tax Court (R. 54-65). Recognizing that the Tax Court had expressly followed the prior decision of the Court of Appeals for the Seventh Circuit in *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943, and the Tax Court's own prior decision in *Luther Bonham* (1936) 33 B.T.A. 1100, on the identical problem (R. 54, 57), the court below refused to follow those decisions. It held that since the transaction *with the cash included* was not a reorganization under § 112(g)(1)(B), gain on the exchange of the stock as well as to the extent of the cash received

should be recognized. In so ruling it completely disregarded the specific direction in § 112(c)(1), providing that if the exchange would be within the provisions of § 112 (b)(3)—i.e., would qualify as a stock-for-stock reorganization—*if* it were not for the fact that the property received in the exchange consisted not only of stock but also of money,

> "then the gain * * to the recipient shall be recognized, but in an amount not in excess * * of such money * *."

In so ruling the court also adopted an interpretation, directly contrary to that in the *Howard* case, of the provisions of § 112(e) of the 1939 Code (53 Stat. 39; Appx. infra, p. ii), the correlative section dealing with *losses* from exchanges not solely in kind. *Howard* pointed out that the Commissioner's position would permit a taxpayer to escape the application of this provision by adding a nominal amount of cash to a stock-for-stock exchange and thus convert a paper loss into a tax loss. In the instant case, the court below considered that "Congress would seem to have weighed" these "undesirable potentialities" against the interpretation adopted by the court and to have accepted the consequences (R. 63-64).

The admitted effect (R. 64) of the decision is to write into § 112(c)(1) an unexpressed exception, as though that statute read:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section (*otherwise than as a reorganization as defined in subsection (g)(1)(B) or subsection (g)(1)(C) of this section*) if it were not for the fact that the property received in

exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

SUMMARY OF ARGUMENT

The provisions of § 112(c)(1) of the 1939 Code literally and exactly fit the Turnbow exchange; hence the gain immediately recognized is limited to the net cash received. There is no dispute that the transaction as it stands is not a "reorganization" as defined; the case is that it would be such if it were not for the fact that cash was included. Turnbow's payment of the full tax on the cash, and postponement of recognition of gain as to the stock, are precisely consistent with the basic legislative pattern. There is no tax avoidance.

This literal application of § 112(c)(1) is the only reading of that statute consistent with the application of its counterpart § 112(e), and is further confirmed by the language of § 112(d).

With the language of the statute, as well as the legislative pattern, being as clear as it is, resort to committee reports or other legislative history is superfluous; but in any event the pertinent legislative history forcefully supports the taxpayer's literal reading of the statute. The Treasury regulations are also consistent.

The Commissioner and the court below err in contending that because a transaction as it stands does not fit within § 112(b)(3), it therefore does not fit within § 112 (c)(1). Section 112(c)(1) by its express terms applies to transactions which as they stand (because of the inclusion of money or other property) do not fit within § 112(b)(3) but would do so if the boot element were not present. That is the situation here.

ARGUMENT

FIRST: THE PROVISIONS OF § 112(c)(1) OF THE 1939 CODE LITERALLY AND PRECISELY FIT THE TURNBOW EXCHANGE. CONSEQUENTLY, THE GAIN IMMEDIATELY RECOGNIZED IS LIMITED TO THE NET CASH RECEIVED UPON THE EXCHANGE.

The Commissioner's entire case rests upon one misconception: that the problem somehow involves the question whether the transaction *as it stands* is a "reorganization" as defined in the code. Section 112(c)(1) plainly says exactly the opposite, as the language of the statute demonstrates.

Section 112(c)(1) declares that:

> "(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—
>
> (1) If an exchange *would be* within the provisions of subsection (b) • • (3) • • of this section *if it were not for the fact that* the property received in exchange consists not only of property permitted by such paragraph • • to be received without the recognition of gain, but also of • • money, then the gain • • to the recipient shall be recognized, but in an amount not in excess of • • such money • •" (emphasis added).

The Turnbow transaction fits the statutory description in § 112(c)(1) with literal exactitude. In order to "be within the provisions of subsection (b)(3)" (Appx. infra, p. i), the transaction, in the present context, would have to be an exchange of stock or securities (a) "in a corporation a party to a reorganization," (b) "in pursuance of the plan of reorganization," (c) "solely for stock or securities • • in another corporation a party to a reorganization." Also in this context, "reorganization" means "the acquisition by one corporation, in exchange solely for all or part of its voting stock, of at least 80 per centum of the voting stock • • of another corporation" (§ 112(g)(1)(B); Appx. infra, p. iii).

In Turnbow, "if it were not for the fact that" the property received in exchange consisted not only of voting stock of Foremost but also of money, the transaction *would have been* an exchange of stock in one corporation "solely for stock • • in another corporation." Also, if cash had not been included, each of the two corporations *would have been* "a party to a reorganization" and the transaction would have been carried out in pursuance of a "plan of reorganization." The particular kind of reorganization would have been as defined in § 112(g)(1)(B), to wit, "the acquisition by one corporation [Foremost], in exchange solely for • • a part [82,375 shares] of its voting stock, of at least 80 per centum [in fact 100%] of the voting stock • • of another corporation [Supply]." Thereupon, under the reorganization plan, Supply was to become and continue operation as a wholly owned subsidiary of Foremost.[4]

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[4]Other aspects of the reorganization—which even with the cash included was a true reorganization in the corporate sense—are summarized in the findings of fact (R. 33-34), and see, supra, this brief, page 4.

Section 112(b)(3) providing for *total* nonrecognition of gain postulates three things:

(1) exchange of stock or securities solely for stock or securities,

(2) in a corporation a party to a reorganization,

(3) in pursuance of a plan of reorganization.

There is no claim that the Turnbow exchange as it stands—i.e., with the cash included—meets these postulates for total nonrecognition of gain. But § 112(c)(1) does not refer to § 112(b)(3) in relation to the transaction *as it stands*. The reference is expressly hypothetical—"if it were not for the fact" that cash was included. So, hypothetically *excluding* cash, the transaction fits all three postulates, and § 112(c)(1) by its terms applies. There is no possible justification, expressed or hinted at in the statutory language, for splitting the reference so as to apply the hypothetical elimination of the cash element to *one* of the conditions *alone;* i.e., in determining whether the exchange is "solely for stock or securities," but not in determining whether it is "in pursuance of a plan of reorganization" as defined in § 112(g)(1).

The Court of Appeals for the Seventh Circuit in *Howard v. Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943 readily recognized this logic. The question was the same as in the instant case. The court concluded (238 F.2d 948):

> "Thus we may conclude that, in determining when these so-called 'boot' provisions apply, Congress intended that the transaction is to be considered separate and apart from the 'boot' received in determining whether it meets the nonrecognition provisions.

> If the transaction, absent the 'other property or money', fulfills the requirements of § 112(b) (3), then gain is to be recognized to the extent that 'boot' is received.
>
> In the present case, *but for* the cash received in exchange for 19.81% of the common stock of Binkley, the transaction would have met the 'solely' requirement of § 112(g) (1) (B) and fallen within the scope of § 112(b) (3). To the extent that 'boot' was received, gain would be recognized under our interpretation of the application of § 112(c) (1)" (italics by the court).[5]

So we re-emphasize, this case nowhere involves the question whether the transaction *as it stands* is a "reorganization." Section 112(c)(1) expressly deals with situations which *as they stand* do *not* qualify under § 112(b) (3) because of the inclusion of boot, but would qualify if boot had not been included. That is the case at bar.

The fallacy in the contrary reasoning is self-evident. The argument is epitomized in the penultimate sentence of the opinion below (R. 64):

> "In the case before us, then, the existence of boot prevents § 112(g) (1) (B) from applying; since no reorganization exists, § 112(b) (3) cannot apply; § 112(c) is then also inapplicable."

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[5]The same reasoning—i.e., "eliminate the cash and see what the transaction would then be"—was also the basis of a number of prior decisions under § 112(c)(1) and its predecessors: *Luther Bonham* (1936) 33 B.T.A. 1100, 1104; *Elizabeth Bruce* (1934) 30 B.T.A. 80, 82-83 (reversed on factual grounds (D.C.Cir. 1935) 76 F.2d 442); *R. C. Love* (1939) 39 B.T.A. 172, 180; *First Seattle D. H. Nat. Bank v. Commissioner of Int. Rev.* (9 Cir. 1935) 77 F.2d 45, 47, 48-49, as well as of the Tax Court in the case at bar (R. 38-39). Until the advent of the decision below, we know of no decision which did otherwise.

This is to say that, because the transaction does not fit the situation described in § 112(b)(3), therefore it does not fit the contrary situation described in § 112(c)(1). The non sequitur is manifest.

To find such a conclusion anywhere in the words of § 112(c)(1) would require rewriting the section. The words as written are the expressed intent of Congress (*United States v. Mo. Pac. R. Co.* (1929) 278 U.S. 269, 278).

SECOND: THE LITERAL APPLICATION OF THE WORDS OF § 112(c)(1) FITS THE BASIC LEGISLATIVE PATTERN, EFFECTING THE IMMEDIATE RECOGNITION AND TAXATION OF GAIN SO FAR AS THE CASH BOOT IS CONCERNED AND POSTPONEMENT OF TAXATION AS TO THE STOCK UNTIL SOME LATER TAXABLE DISPOSITION OF IT.

Section 112(c)(1) with its predecessor sections has stayed in the law substantially in its present form since 1923. During all that time the basic legislative pattern has been clear and unchanged:

> Section 112(a) and its predecessors establish the starting point; gains from sales and exchanges are immediately fully taxable *except*:—
>
> Gains from exchanges solely in kind (§ 112(b)) are tax free at the time (until profit is actually realized through some later taxable disposition of the property received); losses from such exchanges are likewise not recognized at the time;
>
> Gains from exchanges not solely in kind (§ 112(c)), where partly in kind and partly for money or other property (boot), are immediately taxable but not in excess of the value of the boot;
>
> Losses from exchanges not solely in kind (§ 112(e)) are not recognized.

When the taxpayer has merely exchanged one thing for another of the same kind, in all practical effect he has just what he had before, merely in different form. The basic policy of the income tax structure, then, is to postpone taxation of the property received in kind until it should become the subject of some later taxable transaction, and to limit any immediate tax to the amount of any money or property other than in kind which the taxpayer receives in the exchange. This is the policy which runs throughout §§ 112(a), (b), (c), (d) and (e).

The policy is thus summarized in a report of the subcommittee of the House Ways and Means Committee in connection with the Revenue Act of 1934 (Hearings before the Committee on Ways and Means, House of Representatives, 73d Congress, 2d Session, in connection with Revenue Revision 1934, pp. 59-60):

> "The underlying principle behind all of the exchange and reorganization provisions of the present law is that they do not result in tax exemption, but that the tax is postponed until a gain is realized from a pure sale or what amounts to a pure sale. The reasons assigned for such a policy are—
>
> (1) That such provisions prevent much of the uncertainty and litigation which was involved in the prior income-tax laws;
>
> (2) Normal business adjustments will not be interfered with if so-called 'paper profits' are exempted;
>
> (3) The revenues of the Government will be increased by preventing taxpayers from taking colorable losses."

The reorganization provisions are "tax-*deferring*, rather than tax-*exempting*, provisions" (Paul, Studies in Federal

Taxation, Third Series, 1940, p. 4). Transactions of this nature "are deemed by Congress to be transitional, continuing transactions which are not sufficiently 'closed' to justify *economically* • • the imposition of capital gains tax at the immediate moment." As to other types of income in the form of the equivalent of cash, there is an immediate imposition of tax; but "the legislative intent in the reorganization provisions is to permit nothing more than a postponement of tax incidence to some future time when there is more than a 'mere change in the form of ownership'" (id. pp. 4-5).

This policy fits the instant case. Turnbow has exchanged his voting stock of Supply for voting stock of Foremost, plus $3,000,000 in cash; Supply continues operation as a subsidiary of Foremost with a new executive structure. Turnbow has paid his tax on the cash component. As for the stock, he now holds voting stock of Foremost in lieu of voting stock of Supply in the course of reorganization of the latter. On the voting stock component of the transaction, Congress has postponed the imposition of the tax until the taxpayer sells or otherwise disposes of the stock in some way so as to convert any paper profit into an actual profit.

THIRD: THERE IS NO TAX AVOIDANCE. TURNBOW HAS PAID HIS FULL TAX ON THE CASH RECEIVED. WHEN HE MAKES ANY TAXABLE DISPOSITION OF THE FOREMOST STOCK, THE GAIN THEN REALIZED WILL BE SUBJECT TO TAX.

The propositions stated in the heading need no elaboration. Under § 112(c)(1), Turnbow was subject to immediate tax upon the cash part of the transaction, and has

paid his tax (R. 35). When he makes any taxable disposition of the Foremost stock, the gain then realized will be subject to tax. There is no tax avoidance.

FOURTH: THE LITERAL APPLICATION OF § 112(c)(1) AS ABOVE DEMONSTRATED IS THE ONLY APPLICATION OF THAT STATUTE CONSISTENT WITH THE APPLICATION OF § 112(e), ITS COUNTERPART WHERE LOSS HAS RESULTED, PRESCRIBING NONRECOGNITION OF SUCH LOSSES.

Section 112(e) of the Internal Revenue Code of 1939 covers the treatment of *losses*, in contrast to gains, from exchanges of property not solely in kind. Section 112(e), closely paralleling the language of § 112(c)(1), provides:

> "If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, * * of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

The parallel language of the two sections demands a like reading *(Davies Warehouse Co. v. Bowles* (1944) 321 U.S. 144, 150)—a proposition recognized in the *Howard* case, supra, and by the court below (R. 64). In *Howard*, the Court of Appeals for the Seventh Circuit reviewed the legislative history of § 112(e), particularly the report of the House Ways and Means Committee (H.Rept. 179, 68th Cong., 1st Sess., p. 15; C.B.1939-1, Pt. 2, pp. 241, 252) explaining the precursor of that statute (238 F.2d 948):

> *"Unless some provision is made for cases in which part of the consideration is money, the provisions of*

> *subdivision (b) could be avoided and the entire amount of the loss recognized if a small amount of money were received in addition to the specified property.* The only way to cover such a case and prevent the taxpayer from taking the entire loss by adding a small amount of money to the property received is to provide that no loss shall be recognized, otherwise the law might be evaded" (italics by the court).

If § 112(c)(1) did not apply to transactions qualifying as "B" or "C" reorganizations (i.e., reorganizations of the types defined in § 112(g)(1)(B) and (C)) except for the receipt of so-called "boot," correspondingly § 112(e) would not be applicable to such exchanges. In such event, it would be a simple matter to include in an otherwise obvious "reorganization" a nominal amount of boot, and thus forestall the application of § 112(e). "Paper losses" could readily be turned into tax deductible losses by this expedient. As the court in the *Howard* case pointed out (238 F.2d 948):

> "* * if respondent's argument is pursued to its ultimate conclusion, a taxpayer could have his entire loss recognized merely by taking slightly less stock in exchange for money or other property."

Hence the court in *Howard* concluded (238 F.2d 948) that Congress intended the transaction to be considered separate and apart from the "boot" received in determining whether it met the nonrecognition provisions—thus confirming its like conclusion as to the interpretation of § 112(c)(1). In the instant case the court below expressly referred to this determination in the *Howard* case (R. 62) and refused to follow it. Instead the court below assumed,

without justification, that Congress accepted the potentialities of tax evasion (converting paper losses into tax losses by injecting a trifling amount of cash) which attend the Commissioner's argument (R. 63).[6]

FIFTH: SECTION 112(d) REAFFIRMS THE TAXPAYER'S READING OF SECTION 112(c).

Section 112(d) of the 1939 Code provides:

> "If an exchange would be within the provisions of subsection (b) (4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permit-

[6]In support of its assumption, the court below quoted out of context (R. 63) a sentence from the House Ways and Means Committee Report (H.Rept. 704, 73d Cong., 2d Sess., 14), from which, said the court, it would appear that Congress relied upon the other definitions in § 112(g)(1) to avoid the danger of tax avoidance. The full context of the report makes it clear that the "other reorganization provisions" to which the committee referred were not the remaining definitions in § 112(g)(1), but were the other reorganization provisions in § 112, primarily the various provisions of § 112(b) and (e).

In a footnote (R. 63) the court below also referred to a report of a subcommittee of the House Ways and Means Committee recommending elimination of all the exchange and reorganization provisions. The full committee rejected the suggestion. "The committee decided that, under present conditions, the wiser policy is to amend the provisions drastically to stop the known cases of tax avoidance, rather than to eliminate the sections completely" (H.Rept. 704, 73d Cong., 2d Sess., 13; C.B. 1939-1, Pt. 2, 564). Far from expressing an intention to accept tax avoidance as a necessary evil, the full committee proceeded on the intention to stop cases of tax avoidance.

This misuse of legislative history by the court below is further compounded by its disregard of the committee report expressly dealing with the predecessor of § 112(e) (§ 203(f) of the Revenue Act of 1924) which made plain the intention of Congress to prevent, rather than to accept, loss taking. This report is more fully discussed and quoted from in the review of legislative history infra this brief, pages 21-22.

ted by such paragraph to be received without recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed."[7]

Here again Congress has decreed limited recognition of gain in a transaction which, *as it stands*, would not be a reorganization because of the inclusion of other property or money, but which hypothetically *would be* a reorganization if the boot were disregarded. Again the language is clear and explicit; there is no hint of hidden exceptions. Moreover, in this section Congress twice speaks of "the plan of reorganization" in the same breath with the receipt of "other property or money." If the Commissioner's contention were correct, the inclusion of the boot would defeat the full application of the section because subsection (b)(4), like subsection (b)(3), postulates "a party to a reorganization * * in pursuance of the plan of reorganization"; yet within the express terms of § 112(d) Congress speaks generally of "the plan of reorganiza-

[7]These provisions first appeared in the Revenue Act of 1924 as § 203(e), concurrently with § 203(f) which became § 112(e) of the 1939 Code.

tion" in connection with exchanges which include "other property or money."

SIXTH: THE COMMISSIONER'S CONTENTION CANNOT BE JUSTIFIED BY ANYTHING IN THE LEGISLATIVE HISTORY OF § 112(c)(1) OR OF ITS RELATED STATUTES. ON THE CONTRARY, THE LEGISLATIVE HISTORY CONFIRMS THE EXPRESS WORDS OF THE STATUTE.

Where the language of the statute is clear and unambiguous, as it is here, excursions into legislative history and other extraneous materials are not only superfluous but improper,

Gemsco, Inc. v. Walling (1945) 324 U.S. 244, 260;
Helvering v. City Bank Co. (1935) 296 U.S. 85, 89;
United States v. Mo. Pac. R. Co. (1929) 278 U.S. 269, 278;
Van Camp & Sons v. Am. Can Co. (1929) 278 U.S. 245, 253-254,

—a rule "which applies with peculiar strictness" to taxing statutes,

Crooks v. Harrelson (1930) 282 U.S. 55, 61.

However, when the legislative history of § 112(c)(1) and related statutes is examined, it is seen to confirm the intent of Congress as embodied in the express words of the statute,[8] despite efforts of the Commissioner and of the court below to find indications to the contrary.

Sections 112(c)(1) and (e) have been in all successive revenue acts since the Revenue Act of 1924 without sub-

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[8]Legislative history "may be noticed in *confirmation* of the meaning conveyed by the words used" (*United States v. Mo. Pac. R. Co.*, supra, 278 U.S. 269, 278 (emphasis added).

stantial change. The counterpart of § 112(c)(1) was originally enacted as § 202(e) of the Act of March 4, 1923, 42 Stat. 1560. Prior to that time taxpayers were permitted to offset the value of any boot received in an otherwise tax-free exchange against their investment in the property exchanged before boot became taxable. This treatment was objectionable as it permitted the receipt of cash frequently without tax in the case of exchanges not solely in kind (H.Rept. 1432, 67th Cong., 4th Sess., 3 (C.B. 1939-1, Pt. 2, 845)). This report goes on to state:

> "The bill provides that the amount of gain resulting from such exchange shall be computed in accordance with the ordinary method, which is that the gain is computed by subtracting from the total value of all the property received in exchange the cost of the property given in exchange, but with a provision that the taxable gain shall not exceed the amount of the 'boot' received in exchange. Thus, if a taxpayer exchanges stock which cost him $100 for stock in a new corporation, together with $100 in 'boot,' the stock of the new corporation received in exchange would be valued, and if it is found that it is worth $100 the total amount received by the taxpayer has been $200, which is $100 in excess of the cost of the old, and he would therefore, under the proposed law, pay a tax on a gain of $100. If, however, the amount of the 'boot' received is only $95 and the stock in the new corporation is worth $105, he has made the same gain of $100, but he would be taxed only on $95, namely, the amount of the 'boot' received in exchange. *The reason for this is that the profit, so far as it is contained in the new stock received, has not yet been realized, and therefore should not be taxed until the new stock is sold or in some way disposed of so that the profit will be actually realized*" (emphasis added).

This report was approved by the Senate without change (S.Rept. 1113, 67th Cong., 4th Sess., 1-3 (C.B. 1939-1, Pt. 2, 845)). It clearly demonstrates the manner in which the "boot" provision was to operate, and there has been no change in the substance of that provision since that time.

The Revenue Act of 1924 for the first time included § 203(f) (the predecessor of § 112(e) of the 1939 Code). The Ways and Means Committee report on this subsection stated (H.Rept. 179, 68th Cong., 1st Sess., 15 (C.B. 1939-1, Pt. 2, 252)):

> "Section 203(f): There is no provision in the existing law which corresponds to subdivision (f), and there is no ruling by the Treasury Department on a case such as is covered by this subdivision. This subdivision provides that in the case in which 'boot' is received in connection with a transaction from which there would otherwise be no deductible loss, no loss is to be recognized. In case the exchange results in a gain, the situation is covered in subdivision (d)(1) by a provision that the gain shall be recognized in an amount not in excess of the 'boot.' This limitation, however, is not a logical one, if applied to the case of an exchange resulting in a loss. Subdivision (b) of this section provides that no loss shall be recognized if the entire consideration for the exchange is a certain type of property. Unless some provision is made for cases in which part of the consideration is money, the provisions of subdivision (b) could be avoided and the entire amount of the loss recognized if a small amount of money were received in addition to the specified property. The only way to cover such a case and prevent the taxpayer from taking the entire loss by adding a small amount of money to the

property received is to provide that no loss shall be recognized, otherwise the law might be evaded."[9]

The legislative history of these complementary provisions demonstrates that Congress did not intend either that the scope of the requirements of § 112(b) for tax-free exchanges could be avoided by the simple expedient of injecting a nominal amount of boot into the exchange, or that gains from exchanges not solely in kind should be recognized in their entirety.

The committee reports accompanying the statutory revisions in 1934—the changes on which the Commissioner bottoms his argument—carry forward the same treatment of limited recognition of gain in "boot" situations, and particularly demonstrate that Congress specifically intended to apply exactly the same treatment to "B" and "C" type reorganizations as to other types.

Congress was concerned, as clearly disclosed by the full context of the committee reports, with the tax-free receipt of stocks and securities by stockholders who had substantially changed their interest, and more particularly, with the prevention of loss-taking when the shareholders had not changed the nature of their interest.

Section 112(c)(1) is not even mentioned in any of the committee reports on the Revenue Act of 1934, and the content of the reports as a whole shows that the revision of § 112(g) was in no way concerned with the transaction in the present case.

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[9]The contemporaneous Senate report (S.Rept. 398, 68th Cong., 1st Sess., Pt. 2, 16 (C.B. 1939-1, 277)) is practically identical in wording.

The Senate Finance Committee report on the 1934 Act explained the new definition of a reorganization exchange, adding reference to the acquisition by one corporation solely for its voting stock of at least 80 per cent of the voting stock and all other classes of stock of another corporation, or substantially all the properties of such other corporation. This report stated (S.Rept. 558, 73d Cong., 2d Sess., 16-17 (C.B. 1939-1, Pt. 2, pp. 598-599)):

> "Your committee is in complete agreement with the purposes of the House bill which aim at tax avoidance schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State can not ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. * *
>
> * * * * *
>
> The committee believes that these transactions, when carried out as prescribed in this amendment are in themselves sufficiently similar to mergers and consolidations as to be entitled to similar treatment. It will be noted that the proposed amendment requires that (1) the acquiring corporation must obtain at least 80 percent of the * * stock of the other corporation, * * and (2) the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation."

Specifically the Senate Finance Committee believed that transactions of this type were sufficiently similar to mer-

gers to be entitled to similar tax treatment. This similarity could scarcely exist if the injection of a nominal amount of cash in the one case (mergers) would result in limited recognition of gain, while injection of a nominal amount of cash in the other case ("B" and "C" type reorganizations) would result in recognition of the entire gain. Such equality of treatment is natural and reasonable. It is not uncommon—rather it is usual—that stockholders of component corporations in mergers and consolidations receive a substantial amount of cash, as well as innumerable combinations of stock and securities, in exchange for their previous interests. The distribution of boot in a merger is frequently employed as a device which equalizes values of the merged corporations (cf. *Isabella M. Sheldon* (1946) 6 T.C. 510). Congress well knew this.

Moreover, both the Senate and the House reports with respect to the 1934 Act demonstrate an overriding concern with the necessity of preventing stockholders from incurring large tax losses under circumstances where their interests remain substantially unchanged before and after the exchange. In view of the financial condition of the economy at that time, this concern is entirely understandable. If subsections "B" and "C" had not been included in the definition of a reorganization under § 112(g), § 112 (e) would not have prevented the taking of substantial paper losses, because § 112(e) disallows losses only in transactions which but for the boot would have come within 112(b)(3) and 112(g). Certainly, then, Congress could not possibly have intended to permit loss-taking by the simple expedient of injecting a nominal amount of cash or other property into the exchange, which would

have been the result if in "B" and "C" type reorganizations such cash or other property were also distributed. The above Senate Finance Committee Report No. 558, 73d Congress, 2d Session, 17 (C.B. 1939-1, Pt. 2, 599) went on to state:

> "Your committee approves the retention of the exchange and reorganization provisions with these changes [reinstatement of B and C type reorganizations]. Reorganizations are now being consummated in the majority of cases to reduce the capital structure, and to strengthen the financial condition of the participating corporations. If the reorganization provisions were omitted from the bill, many stockholders and bond-holders could take large losses, although they might retain substantially their former interests in the enterprise. Hence, the Treasury has little or nothing to gain by the elimination of these provisions, while, on the other hand, some legitimate and desirable business readjustments would be prevented."

These, then, were the objects that Congress had in mind—to equalize tax treatment of statutory mergers and consolidations and transactions which, though similar in substance, technically would not meet local statutory requirements for mergers and consolidations; and to prevent the taking of paper losses in boot situations—*not* to make special and contradictory exceptions in the application of § 112(c)(1).

Finally, in 1939, in connection with the so-called "Hendler amendment,"[10] the committee reports stated unequiv-

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[10]In *United States v. Hendler* (1938) 303 U.S. 564, this court had held that the assumption of liabilities in a statutory merger

ocally the broad intent of the statute to postpone the recognition of gain in corporate acquisitions, except where "other property or money" was received and then to recognize the gain only to the extent of the latter. As the House Committee stated (H.Rept. 855, 76th Cong., 1st Sess., 18 (C.B. 1939-2, p. 518)):

> "It has long been the policy in our income tax law to give due consideration to the exigencies of business in connection with corporate reorganizations by postponing, in certain specifically described instances, the recognition of gain realized in such transactions. In general, if gain is realized in such a transaction, ***non-recognition of the entire gain*** is allowed only where, under the specifically defined circumstances, the taxpayer transfers property and receives in exchange therefor stock or securities in a corporation which is a party to the reorganization. If, in addition to such stock or securities, other property or money is received, ***gain is recognized to the extent of such other property or money***" (emphasis added).

These are plain expressions of the intent of Congress. They confirm the literal language of the statute.

The references above given are to the Congressional Committee reports dealing with the provisions involved in this case—§ 112(c)(1) and, by correlation, § 112(e). By contrast, the references cited by the court below are to another question entirely—the laws dealing with *total* non-

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constituted taxable boot to the merged corporation under §§ 112 (b)(4) and (d)(2).

By the "Hendler amendment" Congress sought to prevent the assumption of liabilities from being considered boot and at the same time prevent such assumption from disqualifying the transaction under § 112(g)(1)(C); also to insure that the tax basis carryover provisions applicable to tax-free exchanges should apply to such transactions.

recognition of gains from exchanges solely in kind. There is no dispute about them; they simply do not apply.

For example, the court below first cites (R. 58-59) a committee report dealing with § 112(g)(1) and relating to reorganizations *without income tax liability*. Admittedly, the Turnbow transaction, with the cash included, was not such a reorganization without income tax liability—Turnbow was liable for and paid the tax on the cash—but *it would have been a reorganization without income tax liability if it were not for the fact that cash was included*, and we have a § 112(c)(1) situation precisely.

Next, the court below cites (R. 59) a letter from the Secretary of the Treasury, which mentions the desirability of permitting business readjustments *without tax consequences* where no cash is received. The same observations apply; the reference is not to the § 112(c) situation but to the total nonrecognition situation.

Third, the court below cites (R. 59-60) a subcommittee's suggestion which was *not* adopted, and then a House committee's suggestion which was *not* adopted—certainly no expressions of the intent of the contrary provisions which Congress did adopt.

Fourth, the court below cites (R. 60) the Senate Committee report dealing with § 112(g)(1)(B) as finally adopted. This report, however, (1) makes the point of similarity with mergers and consolidations (supra, p. 23) which strongly indicates the intent to provide parallel tax treatment for A-, B-, C- and D-type reorganizations rather than to exclude B and C reorganizations from such treatment as the court below theorized, and (2) refers to restrictions designed to prevent tax avoidance by lim-

iting the *total* nonrecognition situations but not otherwise relating to the § 112(c)(1) situation.

The next bit of legislative history (R. 61-62) cited by the court below was the "Hendler amendment" (supra, p. 25) providing that in a C-type reorganization the assumption of liabilities by the acquiring corporation should be disregarded in determining whether an exchange was solely for voting stock. While the court below suggests (R. 62) that under our construction of § 112(c)(1) this amendment was unnecessary, that conclusion is wholly in error. The stock of the acquiring corporation would ordinarily pass through to the shareholders of the acquired corporation, but nothing passes to them in respect of the assumed liabilities. Hence, under the doctrine of the *Hendler* case (*United States v. Hendler* (1938) 303 U.S. 564) the entire gain would be taxable to the shareholders because (1) the transaction would not attain total nonrecognition under § 112(b)(3) because not within the definition of a reorganization, and (2) it would not attain limited nonrecognition under § 112(c)(1) because the shareholders *received* no money or other property in addition to the stock. The Hendler amendment accorded total nonrecognition to this situation. It was necessary without any regard to § 112(c).

Also contrary to the court below, the committee reports accompanying the Hendler amendment, as noted above, unequivocally demonstrate the applicability of the § 112(c)(1) principle to the situation where money is added to an exchange of stock in a corporation which is a party to a corporate reorganization (supra, p. 26), and certainly indicate nothing to the contrary.

The court below next cites (R. 62) the 1954 Code amendment (§ 368(a)(2)(B)), amending the definition of a C-type reorganization (exchange by a corporation of its voting stock for substantially all the assets of another corporation) to permit the transaction to include boot as payment for up to 20% of the assets of the acquired corporation and still qualify as a reorganization—an amendment which the court said would also be unnecessary if our reading of § 112(c)(1)[11] is correct. The amendment was, however, necessary on totally different grounds. The 1954 Code also newly included the terms of § 381, a relief measure permitting and requiring the successor corporation in a C-type reorganization to carry over the tax attributes of the transferor corporation (Appx. infra, p. vi). These important effects, such as net operating loss carryover, accounting methods, earnings and profits carryover—for all practical purposes the entire tax history of the transferor—hinge directly upon qualifying within the definition of a C-type reorganization.

In summary, the legislative history establishes:

First, Congress intended as a broad policy to postpone tax effects as to like-for-like exchanges in a wide variety of transactions, considering it appropriate to delay the incidence of taxation until some profit or loss should actually be realized. At the same time, Congress provided for immediate taxation of "boot" additions to like-for-like exchanges.

Second, in adopting the 1934 changes, including all the definition provisions upon which the Commissioner now

[11]Which, in the 1954 Code, has become § 356(a)(1). (Appx. infra, p. iv.)

relies, Congress expressly intended to provide similar tax treatment as between mergers and consolidations, on the one hand, and B-, C- and D-type reorganizations on the other, while doing nothing to touch the limited-recognition provisions relating to "boot" transactions.

Third, nothing cited from the legislative history by the Commissioner or the court below supports the Commissioner's contentions. At the most, their citations reflect the intent of Congress to eliminate certain tax avoidance schemes whereby a stockholder could fabricate a fictitious corporate reorganization and escape all immediate taxation. All references thus cited expressly refer to *tax-free* transactions, never to "boot" transactions immediately taxable to the extent of the boot.

Fourth, most significantly, nothing in the so-called legislative history, dealing with the 1934 or later amendments, makes any reference whatever to the long-standing provisions for iimited recognition of gain in "boot" transactions. The court below assumes that Congress, after the 1934 amendments, intended the hypothesis expressed in §§ 112(c)(1) and (e)—i.e., if it were not for the inclusion of boot—to apply to A- and D-type reorganizations but not to B- and C-type reorganizations. It strains credulity, we respectfully submit, to suppose such an intent on the part of Congress so to reconstruct these provisions without any change in their wording and without a single reference to such supposed effect in any of the reports explaining the legislative changes.

Fifth, the legislative history of the corollary nonrecognition-of-loss provisions (§ 112(e)) conclusively demonstrates the Congressional intent *not* to permit loss taking

through the device of injecting a nominal amount of cash into what would otherwise have been a reorganization in which no gain or loss would be immediately recognized. The contrary assumption of the court below has no valid support.

SEVENTH: THE TREASURY REGULATIONS ARE CONSISTENT WITH AND CORROBORATE THE TAXPAYER'S POSITION.

The Treasury regulations under § 112(c) (Appx. infra, p. viii) merely show by example how the statute operates, providing for nonrecognition of gain in boot transactions except to the extent of the boot. Over many years, extending both before and after the 1934 amendments, the regulations have remained substantially unchanged. The return filed by Turnbow is in harmony with them and with the example showing the operation of § 112(c).

If the 1934 amendment of § 112(g)(1)(B), on which the Commissioner bases his contention, had indeed changed the rule of the "but-for" application of § 112(c), it was obviously incumbent upon the Commissioner to point out the change by an appropriate amendment of the regulations pertaining to the latter section. This he did not do.

An illuminating sidelight in the history of the regulations appears in the series of regulations relating to § 112(g)(1). In connection with the 1934 Act, the Commissioner first issued a regulation (Regs. 86, Art. 112(g)-2) which provided:

> "If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required

> amount of stock, or of the properties, of Corporation Y, the transaction is not a 'reorganization' exchange, *and the gain or loss therefrom will be recognized*" (emphasis added).

From this it would appear that the Commissioner at first considered that the 1934 Act required the recognition of the entire amount of gain or loss on boot transactions that would presumably have qualified as B-type reorganizations *but for* the boot.

By the time of the issuance of Regulations 101 in connection with the Revenue Act of 1938, the Commissioner realized the inconsistency and revised the regulation to read as follows (Regs. 101, Art. 112(g)-2; repeated in Regs. 118, § 39.112(g)-2 in connection with the 1939 Code):

> "If, for example, Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required amount of stock of Corporation Y, the transaction is not a 'reorganization' under section 112(g)(1)(B)."

Both the rationale and the effect of this change are obvious. To permit the recognition of loss in boot transactions of this type would fly directly contrary to the specific nonrecognition-of-loss provisions of § 112(e) as well as contrary to the expressed Congressional intent shown hereinabove. Obviously, too, if it was improper under § 112(e) to recognize loss in the example stated in the regulation, it would be equally improper to recognize the *entire* gain inasmuch as § 112(c) limited the recognition of gain to an amount not in excess of the value of the boot received. In sum, the example given in the regulations,

though not constituting a reorganization under § 112(g)-(1)(B) *as it stands*, would nevertheless be subject to the nonrecognition-of-loss provisions of § 112(e) and the limited-recognition-of-gain provisions of § 112(c); and that is what the revised regulation obviously intended to recognize.

The single reference which the court below has marshaled in support of its conclusion (R. 64) is an excerpt from § 39.112(g)-1(c) of Regulations 118:

> "'From its context the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 112(g). * * The provisions of the Internal Revenue Code referred to in this paragraph [this includes § 112(c)] are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed'" (R. 64—the bracketed interpolation is by the court).

It is plain that the particular reference above to the provisions of the Internal Revenue Code does not have the broad scope attributed to it by the court below. If it did extend to include § 112(c)—even though that section was elsewhere mentioned in that paragraph of the regulations—then the sentence would mean that § 112(c) is inapplicable unless there is a plan of reorganization. This is patently untrue. Apart from the transaction in the case at bar, this reading would exclude such exchanges as a hotel for a hotel-plus-cash, for example, or a farm for a

farm-plus-cash, or innumerable exchanges of like for like-plus-boot which are the very essence of the application of § 112(c). If the sentence of the regulation referred to means anything at all, it must refer only to the various provisions of § 112(g) and the transactions specifically defined in that section.

EIGHTH: THE ERROR OF THE COURT BELOW LIES IN A LOGICAL FALLACY COMBINED WITH A FUNDAMENTAL MISCONCEPTION OF THE ISSUE. THE ISSUE IS NOT WHETHER THE TURNBOW EXCHANGE AS IT STANDS CONSTITUTES A REORGANIZATION—CLEARLY IT DOES NOT—BUT WHETHER § 112(c) APPLIES WHERE THE EXCHANGE WOULD FALL WITHIN THE REORGANIZATION DEFINITION IF IT WERE NOT FOR THE INCLUSION OF CASH.

As the court below epitomized its position (R. 64), the existence of boot prevents the Turnbow exchange from falling within the definition of a reorganization; therefore the transaction does not fit within § 112(b)(3) so as to be wholly *non*taxable; therefore it does not fit within § 112(c)(1) so as to be immediately taxable to the extent of the boot. The fallacy is manifest; there is an utter absence of logical sequitur between the second and final steps. The plain language of § 112(c)(1) deals, not with what *does* fit within § 112(b)(3), but with that which does *not* fit within § 112(b)(3) but which would do so if there were no boot involved. And that is this case.

Again and again the opinion of the court below expands this logical fallacy into a fundamental misconception of the issue in this case. The essence of the court's opinion is to establish that an exchange of stock for stock-plus-

cash cannot be a "reorganization" within the definition of § 112(g)(1)(B). Thus the court said (R. 64):

> "We conclude that, if the 'solely for voting stock' requirement of (B) and (C) reorganizations is to be given the effect intended by Congress, § 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot."

There is no dispute in this case, and never has been, that the Turnbow exchange as it stands does not fit within the § 112(g)(1)(B) definition of reorganization. When the court below says, as it has done repeatedly throughout its opinion, that this is the issue in the case, it is presupposing a dispute that is nonexistent.

The basic issue, in reality, is whether § 112(c)(1) applies to exchanges which, as they stand, are not reorganizations. The answer is that it does. Its essence is that in a like-for-like-plus-boot exchange, the tax effect as to the like-for-like is postponed while the tax effect as to the boot is immediate. This philosophy applies equally well to a voting-stock-for-voting-stock-plus-cash exchange (when the like-for-like element is sufficiently met by the 80 per cent limitation), as to a hotel-for-hotel-plus-cash exchange or a farm-for-farm-plus-cash.

In this there is no quarrel with *Helvering v. Southwest Corp.* (1942) 315 U.S. 194. There this court said that "solely for voting stock" in § 112(g)(1) means what it says. We agree. *Southwest* dealt with a question of tax basis for gain or loss which turned precisely upon whether the transaction was within the definition of reorganization or not. It did not deal with a "would-be-a-reorganization-

but-for" question, and none of the language in the opinion bears upon that question.

There is, therefore, no justification for the suggestion of the court below that to apply § 112(c) according to its literal terms would "frustrate at birth" (R. 61) Congress' intention to tighten the definition of B and C reorganizations when it restricted them to exchanges "solely" for voting stock. Without the amendment, a taxpayer could exchange voting stock for stock and debentures, for example (and thereby change his interest from equity owner to creditor), *tax-free* under § 112(b)(3). Congress decided to change this rule, and did so. Debentures or other securities were no longer tax-free consideration in an exchange for voting stock. To the extent that the consideration might include debentures *in addition* to voting stock, the debentures would be immediately taxable as boot under § 112(c), preserving the literal application and the policy of that statute. Again this is fully in accord with the provisions determining the tax effect where a reorganization as such is concerned, and also fully in accord with the provisions determining the tax effect where a "would-be-a-reorganization-but-for" transaction is concerned.

In net result, the tax pattern is plain, and the words of § 112(c)(1) are plain. They admit no unexpressed exceptions.

CONCLUSION

We respectfully submit that the judgment of the court below is erroneous and should be reversed.

Dated: August 25, 1961.

Respectfully submitted,

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(Appendix Follows.)

Appendix

Internal Revenue Code of 1939:

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

53 Stat. 37.

"(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (l) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(1), 58 Stat. 43.

"(d) SAME—GAIN OF CORPORATION.—If an exchange would be within the provisions of subsection (b) (4) or (10) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(2), 58 Stat. 43.

"(e) LOSS FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

53 Stat. 39, as amended by Revenue Act of 1943, c. 63, sec. 121(d)(3), 58 Stat. 43.

"(g) DEFINITION OF REORGANIZATION.—As used in this section (other than subsection (b) (10) and subsection (l)) and in section 113 (other than subsection (a) (22))—.

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

53 Stat. 40, as amended by Revenue Act of 1939, c. 247, sec. 213(b), 53 Stat. 870, and Revenue Act of 1943, c. 63, sec. 121(d)(4), 58 Stat. 43.

Internal Revenue Code of 1954:

"SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN ON EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

• • • • •

(c) Loss.—If—

(1) section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) the property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized."

68A Stat. 115.

"SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term 'reorganization' means—

* * * * *

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

* * * * *

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

* * * * *

(B) ADDITIONAL CONSIDERATION IN CERTAIN PARAGRAPH (1) (C) CASES.—If—

(i) one corporation acquires substantially all of the properties of another corporation,

(ii) the acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property."

68A Stat. 120-121.

"SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

• • • • •

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354 (b) (1) are met), or (F) of section 368 (a) (1).

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

• • • • •

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

(1) NET OPERATING LOSS CARRYOVERS. * * *

(2) EARNINGS AND PROFITS. * * *

(3) CAPITAL LOSS CARRYOVER. * * *

(4) METHOD OF ACCOUNTING. * * *

(5) INVENTORIES. * * *

(6) METHOD OF COMPUTING DEPRECIATION ALLOWANCE. * * *

(8) INSTALLMENT METHOD. * * *

(9) AMORTIZATION OF BOND DISCOUNT OR PREMIUM. * * *

(10) TREATMENT OF CERTAIN EXPENSES DEFERRED BY THE ELECTION OF DISTRIBUTOR OR TRANSFEROR CORPORATION. * * *

(11) CONTRIBUTIONS TO PENSION PLANS, EMPLOYEES' ANNUITY PLANS, AND STOCK BONUS AND PROFIT-SHARING PLANS. * * *

(12) RECOVERY OF BAD DEBTS, PRIOR TAXES, OR DELINQUENCY AMOUNTS. * * *

(13) INVOLUNTARY CONVERSIONS UNDER SECTION 1033. * * *

(14) DIVIDEND CARRYOVER TO PERSONAL HOLDING COMPANY. * * *

(15) INDEBTEDNESS OF CERTAIN PERSONAL HOLDING COMPANIES. * * *

(16) CERTAIN OBLIGATIONS OF DISTRIBUTOR OR TRANSFEROR CORPORATION. * * *

(17) DEFICIENCY DIVIDEND OF PERSONAL HOLDING COMPANY. * * *

(18) PERCENTAGE DEPLETION ON EXTRACTION OF ORES OR MINERALS FROM THE WASTE OR RESIDUE OF PRIOR MINING. * * *

(19) CHARITABLE CONTRIBUTIONS IN EXCESS OF PRIOR YEARS' LIMITATION. • • •

(20) CARRY-OVER OF UNUSED PENSION TRUST DEDUCTIONS IN CERTAIN CASES. • • •

(21) PRE-1954 ADJUSTMENTS RESULTING FROM CHANGE IN METHOD OF ACCOUNTING. • • •

(22) SUCCESSOR LIFE INSURANCE COMPANY. • • •"

68A Stat. 124-129, as amended by Public Law 74, 84th Congress, 1st Session, c. 143, sec. 2(1), 69 Stat. 134; by Public Law 396, 84th Congress, 2d Session, c. 15, 70 Stat. 7; by Public Law 85-866, 85th Congress, 2d Session, sec. 29(c), 72 Stat. 1628; and by Public Law 86-69, 86th Congress, 1st Session, sec. 3(c)(1), 73 Stat. 139.

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

"§ 39.112 (a)-1 *Sales or exchanges.*

• • • • •

(c) The Internal Revenue Code makes specific provision for the case in which, in addition to property which may be received tax free on the exchange, there is received as boot other property or money. In such a case gain is recognized to the extent of the boot (see section 112 (c) and (d)), but no loss of any kind is recognized (see section 112 (e))."

Code of Federal Regulations, Revised 1953, page 596.

"§ 39.112 (c)-1 *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.* (a) If in any transaction in which prop-

erty held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment: or if common stock is exchanged for common stock, or preferred stock for preferred stock, in the same corporation and not in connection with a corporate reorganization; or if property is transferred by one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (5), there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then

(1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

(b) The application of this section may be illustrated by the following example:

Example. A, who is not a dealer in real estate, in 1952 exchanges real estate, which he purchased (for investment) in 1940 for $5,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of $6,000, and he receives in addition $2,000 in cash. The gain from the transaction is $3,000, but is recognized only to the extent of the cash received of $2,000.

(c) Consideration received in the form of an assumption of liabilities is to be treated as "other property or money" for the purposes of so much of section 112 (c) as relates to section 112 (b) (1) and (2). As to the proper treatment of such consideration for the purposes of so much of section 112 (c) as relates to section 112 (b) (3), see § 39.112 (g)-4 and so much

of section 112 (c) as relates to section 112 (b) (5), see section 112 (k).

(d) See section 113 (a) (6) for the basis for determining the gain or loss from the subsequent sale of the property received in exchanges such as described in this section.

(e) As to the receipt of other property or money on an exchange of stock or securities in connection with a section 112 (g) reorganization, see § 39.112 (g)-4; or in connection with a section 112 (b) (10) reorganization, see § 39.112 (l)-1. As to distributions in pursuance of a plan or reorganization which have the effect of a taxable dividend, see § 39.112 (g)-4, in the case of a section 112 (g) reorganization, or § 39.112 (l)-1, in the case of a section 112 (b) (10) reorganization."

Code of Federal Regulations, Revised 1953, page 612.

"§ 39.112 (c)-1 *Nonrecognition of loss.* (a) Section 112 (c) provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112 (b) (1) to (5), inclusive, or section 112 (b) (10), notwithstanding the fact that there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss."

Code of Federal Regulations, Revised 1953, page 612.

"§ 39.112 (g)-4 *Exchanges in reorganization for stock or securities and other property or money.* (a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the

plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112 (c) (1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, in connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized."

Code of Federal Regulations, Revised 1953, page 619.